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RUEHZL/EUROPEAN POLITICAL COLLECTIVE

C O N F I D E N T I A L SECTION 01 OF 02 REYKJAVIK 000225

SIPDIS

STATE FOR EUR/FO A/S Dan Fried

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TAGS: [EFIN](#) [ECON](#) [PGOV](#) [IC](#)

SUBJECT: ICELANDIC ECONOMIC CRISIS, TIME FOR USG TO GET INVOLVED?

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Classified By: DCM Neil Klopfenstein for reasons 1.4 (b) and (d).

1.(C) Summary: The Icelandic economic crisis continues with no end in sight. The possibility of a Russian loan bailout as well as concerns voiced by some American bankers raise the question of whether greater USG involvement in the crisis is merited. The Icelandic Central Bank announced this morning that its attempts to peg the krona to an index were not working and it would no longer fix the rate. The krona devalued, then stabilized later in the day, but there are significant differences in the exchange rate depending on the financial institution. The Financial Supervisory Authority used the powers from emergency legislation to take control of Glitnir Bank and the takeover went well. Kaupthing remains independent for now; their Swedish branch will receive a 700 million USD loan from the Swedish Central Bank. Relations with Britain are under strain following UK Chancellor Darling's announcement that he seized the UK assets of Icelandic banks, and the media reported that PM Brown wants to sue the Icelandic government to refund British depositors. Prime Minister Haarde stressed in a press conference at 4 pm that the current situation would not affect many decades of friendship between Iceland and the UK. Haarde said he had talked to his colleagues in the Nordics and that the Norwegian Prime Minister had offered Norwegian assistance. Regarding the Russian loan offer, the PM asked at the press conference why Iceland shouldn't call on the Russians if they could help? Despite public assertions that some of Iceland's friends had failed to provide help, the Embassy does not believe the Icelanders have adequately checked out all possibilities of cooperation with U.S. entities. We urged Iceland reps to reach out to U.S. authorities immediately so that "our friends said no" - means they really asked the right questions. End Summary.

12. (U) The Central Bank announced that the fixed rate for the krona was not holding and they would no longer hold the rate. The krona devalued a bit, and then stabilized at the end of the day. We noticed that the exchange rate varies from institution to institution, which less confidence in the krona abroad. The Central Bank rate is 114 ISK/USD, Kaupthing's rate is 96.7 ISK/USD and UBS (a Swiss bank)'s rate is 271 ISK/USD. Today Landsbanki lowered its daily foreign currency withdrawal limits from 200,000 ISK to just 50,000 ISK.

13. (U) The Financial Supervisory Authority (FME) took control of Glitnir Bank last night. The FME has replaced the board of directors and promised similar action as has been taken at Landsbanki. The Minister of Commerce reported at a press conference at 4 pm that the takeover was smooth and had gone well. The only bank of the largest three to remain independent, Kaupthing, announced that their Swedish unit was receiving a 5 billion Swedish krona, or 700 million USD, loan from the Swedish Central Bank.

14. (C) The Director General of the Economic Department of the Ministry of Finance, Thorsteinn Thorgeirsson, told Econoff he was very concerned with the deteriorating situation with the British. He pointed to the media reports that Prime Minister Gordon Brown wanted to sue Iceland over guaranteeing British deposits in Icelandic banks in the UK and UK Chancellor Darling's televised speech on the

Parliament floor stating that he had seized and frozen assets of Icelandic banks in UK. In his 4 pm press conference today, Prime Minister Haarde stated that the Icelandic Government will work with the British government to find a solution to ensure the British deposits in the Icelandic accounts IceSave are safe. Haarde added the current situation would not affect many decades of friendship with the UK.

15. (C) In reaction to Icelandic government assertions yesterday that the Icelanders were turning to Russia because friends (i.e., the U.S.) had failed to respond to pleas for help, the Embassy checked with both Icelandic and U.S. institutions to ascertain whether the Icelanders had requested help or advice from other than the Federal Reserve. We have only been able to confirm that Central Bank officials have talked to the Chairman of the New York Fed - but not since last week -- and, as Treasury briefed the ambassador on October 6, U/S McCormack phoned the Finance Minister that day. We are at a loss to explain why the Icelanders have not picked up the phone to discuss what they need and what we might be able to help them with, though the stature of Central Bank director David Oddsson may have something to do with a reluctance to open other lines of communication. American bankers here tell us that U.S. support is badly needed, that the Icelandic bank assets are not toxic, and that their problem is short term liquidity worsened by a crisis of confidence.

16. (C) The U.S. has strategic interests in the high north and a sturdy security relationship with post-Keflavik Iceland that both sides have labored to develop. Today the Embassy urged senior reps in the PM's office and elsewhere to at least explore what confidence-building cooperation (other than the credit swaps the Fed turned down) may be possible to develop. We doubt that it would be

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in the interest of the U.S. or NATO for the Icelanders to be beholden to Russia, however "friendly" the loan terms may be.

VAN VOORST